STANDARD & POOR'S PUBLIC FINANCE

Publication date: 04-Nov-2005Primary
Reprinted from RatingsDirect

Vermont; Tax Secured, General Obligation

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Credit Profile
US$30. mil GO bnds ser 2005D due 07/15/2025
AA+
Sale date: 15-NOV-2005
AFFIRMED
$515.400 mil. Vermont go
AA+
OUTLOOK:
STABLE

Rationale

The 'AA+' rating on Vermont's series 2005D GO bonds reflects the state's:

- Strong financial management with conservative debt and budgeting practices, including consensus revenue forecasting in place for more than a decade;
- Varied economy, with tourism as an anchor and high-tech manufacturing a sizable presence; and
- Favorable debt position with a low debt burden, rapid amortization, and a trend of more debt being retired than being issued.

The state's full faith and credit pledge secures the bonds. The state plans to issue the remaining $15 million of the state debt affordability committee's GO debt issuance cap of $45 million for fiscal 2006 in December 2005.

Vermont's financial position remains strong. Fiscal 2005 is estimated to have closed with a $54 million surplus. Following transfers to the health trust account ($21.1 million), the transportation fund ($4.8 million), the teachers retirement fund ($4.0 million), and various other smaller transfer amounts, $19.6 million fell to the general fund budget stabilization reserve. At fiscal 2005 close, the state reserve funds were fully funded at statutory levels, providing more than $112 million in available reserves. The reserve levels were as follows:

- General fund budget stabilization fund balance, $44.5 million;
- Budget reserve surplus, $15.6 million;
- Transportation fund stabilization fund balance, $11 million;
- Education fund budget stabilization reserve, $22.9 million; and
- Human service fund caseload reserve balance, $18.54 million.

The fiscal 2006 general fund budget is conservatively set at just 3.3% above the fiscal 2005 adopted budget. Through September 2005, revenues are up $16 million, or 6.5% of budget. The July revenue estimating conference also increased the projections for fiscal 2006 revenues, after the budget was adopted, and, to date, $20 million of the newly projected revenues are yet to be appropriated. The General Assembly will meet in early January to make budget adjustments, but current estimates project a $25 million-$30 million budget adjustment action, well within available revenues.

Of note in the fiscal 2006 budget is a restructuring of the state's Medicaid system. Through negotiations at the federal level, Vermont has entered into an agreement capping and locking federal Medicaid reimbursements for five years at a 9% rate of increase. In return for the federal level appropriation certainty, the state receives a reduction in reporting requirements and restrictions on what the funds can be used for will be less restrictive. With the program changes, the state expects to be able to manage Medicaid cost increases over the period to be within the capped amount, a risk, which if inaccurate, will fall to the state for funding. State officials believe that the state has a $522 million margin of error over the five-year period as that is the amount between what the guaranteed cap will provide and their estimates to total cost.

Vermont's economic diversification plays a central role in its relatively stable economic performance. The state's annual unemployment rate has been below national levels for more than 20 years. The August 2005 unemployment rate of 2.9% was below the nation's 4.9% rate, continuing that trend.

Vermont continues to maintain a conservative approach to debt issuance. Tax-supported GO debt outstanding was $440 million as of June 30, 2005, and, even including this issue and the $15 million citizens GO bond in early 2006, GO debt is projected to be down to $439 million at June 30, 2006. At fiscal 2005 close, debt ratios are estimated to be an average $749 per capita and 2.1% of personal income. Amortization is rapid, with about 83% retired within 10 years. Vermont has been able to adhere to an annual debt cap for more than a decade.

Outlook

The stable outlook reflects the expectation that the state's prudent financial and debt management practices will lead to continued sound financial operations. Standard & Poor's will continue to monitor the Medicaid cap five-year agreement for potential savings or losses. The stable outlook also anticipates that the state's economy continue to diversify.

Economy

The state weathered the 2001-2002 recession comparatively well, but the layoffs of a single employer (IBM) slowed its full recovery. IBM, the state's leading employer with 6,200 employees, is beginning to rehire after a period with considerable layoffs. Through the national economic slow-down, IBM laid off more than 1,800 employees in Vermont, but in recent months has filled 250 new positions. Following IBM, the state's leading employers are stable and quite diverse. The only other private company employing more than 2,000 is Fletcher Allen Health Care (BBB/Stable/--) with 4,709 employees. Based in Burlington, Vt., Fletcher Allen Health Care is the parent company of Fletcher Allen Hospital, the state's leading hospital and a 500-bed teaching hospital associated with the University of Vermont (A+/Stable/--). A number of firms exceed 1,000 employees, including Chittenden Trust, General Electric Co., Rutland Regional Medical Center, Middlebury College, and a number of retail chains.

Vermont has increased its interdependence with the northeastern U.S. regional and Canadian economy, while its local economy has become more diverse. The increased diversity is important to reduce the effect of economic downturns or periods of stagnant growth, particularly in manufacturing or tourism. Vermont's population has above-average education levels and is currently ranked seventh in the nation as the percent of the population with a college degree. Median household effective buying income continues to strengthen and is currently just below the national average at 98.3% of the national level. Vermont's 2003 income of $30,740 per capita was slightly below the nation's $31,632 per capita average.

The fall foliage and winter ski seasons play a great role in Vermont's economy. The state's chief competitor for the prized ski tourism revenue is Colorado. Increasingly, areas like Killington are being marketed as ski resorts and locations for summer recreational activities, lengthening the tourist season and increasing sales, meals, and lodging taxes.

Finances

Unlike many states, Vermont never fully depleted its reserves during the 2001-2002 recession; in addition, the state already replenished its reserves to statutory levels in fiscal 2004. Audited fiscal 2004 results indicate a $55.0 million general fund operating surplus. After transfers of $26.1 million to various internal service funds and $20.9 million to the general fund budget stabilization reserve, the surplus was reduced to $10.0 million. The $20.9 million added to the budget stabilization fund returned the fund to its statutorily set level: $44.5 million. The state's transportation fund closed fiscal 2004 with a strong $17.0 million surplus, increasing the transportation fund balance to $21.4 million. The education fund, following two years of deficit operations, returned to the positive with a $33.9 million surplus resulting in a $18.2 million undesignated fund balance and a fully funded budget stabilization reserve of $22.8 million. At fiscal year-end 2004, reserves on hand were nearly $73.5 million, including $44.5 million in the general fund stabilization fund, $18.5 million in the human services caseload reserve, and $10.5 million in the transportation fund.

In July 2001, Vermont converted to a new statewide financial management software system. The VISION system is currently operational, but start-up problems caused a delay in the release of the fiscal 2002 comprehensive annual financial reports (CAFR), which in turn has delayed both the fiscal 2003 and fiscal 2004 CAFRs. The state expects that the fiscal 2005 CAFR can be released by Dec. 31, 2005. The fiscal 2002, 2003, and 2004 CAFRs are fully GASB 34 compliant, and received unqualified audit opinions.

Fiscal 2006 budget/'Global Commitment'

The fiscal 2006 budget is conservative, with increases of just 3.4% in general fund expenditures and 3.3% in transportation fund expenditures. Base general fund appropriations will increase to $1.03 billion in fiscal 2006 from a revised $981.3 million in fiscal 2005. The proposed transportation fund appropriations level will increase to $225.9 million in fiscal 2006 from $213.7 million in fiscal 2005. Among other things, the budget funds retention of 10 previously federally funded state troopers, a $10 million increase in the general fund transfer to the education fund, and various tax reform measures designed to close loopholes. The corporate income tax is set to be reduced in two phases implemented on Jan. 1, 2006, and Jan. 1, 2007. This lost revenue is expected to be fully recaptured with changes increasing taxes from corporations with headquarters not located within Vermont but operating within it.

The budget looks to address a growing Medicaid funding deficit through changes in the program being viewed as a national pilot. The change has been labeled 'Global Commitment' by the state as it now expects to be able to use federal funds for previously nonreimbursable sectors. The reform caps the federal reimbursement at a set amount in return for loosening of federal fund use restrictions within the state over a five-year period. The change allows the federal government a more predictable level of annual assistance to Vermont. Vermont estimates that the cost to run the Medicaid program over five years is $4.17 billion and the cap will provide $4.70 billion in funding. The risk the state is assuming is that Medicaid reimbursement costs will not increase more than 9% annually or more than $522 million over the five-year period.

Debt

In fiscal 2005, the state capital debt affordability advisory committee increased the debt cap to $41 million, the first increase over the $39 million limit set in fiscal 1999. The cap increased in fiscal 2006 to $45 million, and is currently set at $45 million again for fiscal 2007. Even with the increase, Vermont will continue to retire more debt than it issues annually. At fiscal year-end 2005, debt ratios were a manageable $749 per capita and 2.1% of personal income. In the Standard & Poor's report titled, "Public Finance Report Card: U.S. States Debt Profiles", available on RatingsDirect, Standard & Poor's Web-based credit analysis reference system, Vermont's conservative debt practices reflected well in the national comparisons. On a total tax-supported debt peer comparison, Vermont ranked 42nd. The state was in the middle of the peer group, 24th and 25th, respectively, in comparing debt per capita and debt to personal income. The state has no current plans to issue variable-rate debt or enter into any swaps.

Unlike many national pension systems, Vermont's state pension system remains strong. The $1.49 billion Vermont Teachers' Retirement System is funded at 90.7% through June 30, 2005, with a $138.1 million unfunded pension liability. The $1.2 billion Vermont State Retirement System is funded at 97.8% through June 30, 2005, with a $25.9 million unfunded pension obligation. The Vermont Municipal Employees' Retirement System is overfunded by 3% and has a $7.8 million surplus. The state expects to be compliant with the new government accounting standards board (GASB) statement 45 addressing other post employment benefits (OPEB). The current assumed OPEB unfunded liability is $828 million.

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